In the

United States
Circuit Court of Appeals,

FOR THE NINTH CIRCUIT.

In the Matter of
RALPH L. STEPHENS,
Bankrupt.

Baash-Ross Tool Company, State Oil-fields Supply Company, Standard Pipe and Supply Company, A. D. Mitchell, Frances Hargrove, and Juanita Cook,
Appellants,

vs.

Ralph L. Stephens,
Appellee.

APPELLANTS' BRIEF ON APPEAL.

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TOPICAL INDEX.

TABLE OF AUTHORITIES CITED.

Cases.

Statutes.

Text Books and Encyclopedias.

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FOREWORD.

This matter comes before the court on an assignment of errors on an appeal from an order discharging the bankrupt from his debts in bankruptcy.

The bankrupt applied for his discharge, and certain creditors, to-wit, Baash-Ross Tool Company, State Oil-fields Supply Company, Standard Pipe and Supply Company, A. D. Mitchell, Frances Hargrove, and Juanita

Cook, filed specifications of grounds of opposition to such discharge. These specifications were five in number and in substance were that:

(1) The bankrupt had, with intent to conceal his financial condition, failed to keep books of account from which his financial condition might be ascertained.

(2) The bankrupt for the purpose of obtaining property or credit from two of the objecting creditors, made a materially false statement in writing concerning his financial condition, showing a net worth of $250,000.00, whereas the bankrupt was insolvent.

(3) The bankrupt with intent to delay, hinder, and defraud his creditors, had removed and concealed and transferred a portion of his property while insolvent, consisting of a membership in the Portero Country Club, and had transferred an automobile under similar circumstances.

(4) The bankrupt, while insolvent, and without consideration, and with intent to defraud creditors, had transferred several parcels of real property.

(5) That within twelve months preceding the filing of the bankruptcy petition, the bankrupt had caused property described in the fourth objection to be conveyed to other persons for the purpose of concealing the same from the process of his creditors.

The matter was heard before the Referee and he made his findings and recommendations thereon, recommending that the bankrupt be discharged. In the report of the Special Master he found the facts as alleged in all of the objections to be untrue. Exceptions to the report of the Special Master were filed and they were by the court

overruled and the report of the Special Master confirmed, the appeal now before this court being on an assignment of errors from the order confirming the report of the Special Master. The controversy resolves mainly around the second, fourth and fifth specifications. Little or no reliance is placed upon the first and third specifications, which charged a failure to keep books and transfer of a club membership and automobile with intent to hinder, delay and defraud creditors respectively. The second specification on the giving of false financial statements, is one mainly relied upon by the appellant.

STATEMENT OF FACTS.

The statements in writing consisted of financial statements given to Baash-Ross Tool Company and State Oilfields Supply Company, respectively, on or about March 3, and October 4 and 10, 1930, and which said financial statements are marked Objector's Exhibits 1, 2 and 3, respectively. [Tr. pp. 73-88, inclusive.]

It is undisputed that these various statements were given by the bankrupt for the purpose of obtaining credit and obtaining extensions of credit from the respective creditors, and that they relied thereon. [Tr. p. 27.]

About three months subsequent to the giving of these statements, and at the time of the examination of the bankrupt under section 21A of the Bankruptcy Act, the bankrupt submitted to the attorney for the trustee an additional statement in writing, showing the condition of his affairs at the time of the filing of the petition in bankruptcy, this being marked Objectors' Exhibit 4. [Tr. pp. 89-91, inclusive.]

There is a very wide discrepancy between the financial statements submitted to the creditors and the statement given by the bankrupt at the time of the bankruptcy hearing, which said discrepancies give rise to the most serious objections urged. It also appears from the testimony of the bankrupt upon the hearing to the objections that there are certain omissions from the financial statements which will be more specifically hereinafter set forth.

On Objectors' Exhibit 1, the bankrupt sets forth a net worth to him of the sum of $235,608.91. On Objectors' Exhibits 2 and 3, given several months later, he shows a net worth of $258,845.99.

In item 8 of Objectors' Exhibit 1, the bankrupt sets forth as an asset the sum of $246,203.40, consisting of real estate, stocks, bonds, etc., and under item 16 of the same exhibit, shows his incumbrances on the land included in item 8 as being $56,073.00. In Objectors' Exhibits 2 and 3, he sets forth his assets, consisting of real estate, stocks and bonds, etc., at the sum of $266,859.39, and shows as incumbrances on the land included in the last above sum, the sum of $70,897.00.

In the Objecting Creditors' Exhibit 4, there is shown as incumbrances upon his land the sum of $114,568.37, or a difference in incumbrances on the land set forth in Exhibits 1, 2 and 3, and that set forth in Exhibit 4, of the sum of $43,671.37. The bankrupt testified, and such testimony is undisputed, that at the time he started dealing with the Baash-Ross Tool Company, and when he went into the oil business in Venice, California, that all of the incumbrances had been placed on the various different real properties. [Tr. p. 62.] In other words, between the time of the giving of the respective financial statements

and the giving of Objectors' Exhibit 4, no additional incumbrances were placed upon his real property. The bankrupt also testified that the item of $70,897.00 set forth as incumbrances upon his land in Exhibits 2 and 3, represented incumbrances on the real estate shown on the statement to the Baash-Ross Tool Company, and that the item "incumbrances on land" represented incumbrances on the real property shown in Objecting Creditors' Exhibit 4. [Tr. p. 30.]

It also further appears from the undisputed testimony of the bankrupt that at the time of the giving of the various financial statements a suit was pending against the bankrupt for a sum approximating $17,000.00, which suit was subsequently reduced to judgment against the bankrupt. No mention is made of this litigation in any of the financial statements. [Tr. p. 28 and p. 33.]

It also appears that in the financial statement to the Baash-Ross Tool Company (Objectors' Exhibit 2) there was set forth as an asset an item consisting of furniture and equipment of the sum of $5269.15. This item was also set forth in Objectors' Exhibit 3, being the financial statement given October 10th, for the purpose of obtaining an extension of time of payment of the claims of the State Oilfields Supply Company, in which the value of such furniture and equipment was placed at $2257.70. When interrogated about this particular item the bankrupt testified that he did not know what the item of $5000.00 for furniture, fixtures and equipment shown on Exhibit 2 meant, unless it was personal furniture. He also testified that he did not have that much furniture; that he did have furniture consisting of office furniture

worth about $550.00, household furniture worth about $1500.00, and a piano worth about $1700.00, making a total value, including the piano, of $3750.00. [Tr. p. 43.] It is also shown from the testimony of Frank Kennedy, who was employed by the Trustee in Bankruptcy, that he was never able to secure or find any of the items of furniture and equipment as set forth in Exhibit 4. [Tr. p. 36.] The same witness also testified that upon making demand upon the bankrupt for the furniture and fixtures, he said that he had no furniture. [Tr. p. 66.] No further explanation was given by the bankrupt of this item. It is also to be observed that in Schedule B2 [Tr. p. 5] in the bankrupt's schedules, he lists "Household goods and furniture, household stores," etc., at $1000.00.

There also appears in Objectors' Exhibit 2, as an asset, an item of "Memberships," of $2335.00. This item of memberships is set forth in Objectors' Exhibit 4 as $2185.00. The bankrupt testified that at the time the statement was made to the Baash-Ross Tool Company, such memberships were pledged to the Bank of Inglewood. [Tr. p. 46.] In the testimony of Kennedy it was found that the estate was unable to dispose of such memberships, and that they were valueless.

It appears from Objectors' Exhibit 4 that the total values placed on the real property of the bankrupt is the sum of $250,400.00, subject to incumbrances of $114,568.37; and while in Exhibits 1, 2 and 3, the bankrupt lumped the real property with stocks, bonds, and other assets, we believe that the values placed upon the various parcels of property in Exhibit 4 are indicative of the

values that he placed on the real property in Exhibits 1, 2 and 3. It is also to be noted that in Schedule B1 [Tr. p. 34] he applied the same values to his real estate as he did in Exhibit 4, with the exception of some parcels which he appears not to have owned at the time of the bankruptcy. A check of the values placed on the various parcels of property by the bankrupt is illustrative of the grossly exaggerated values that were placed on the real estate in Objectors' Exhibit 4. Thus we have Lot 1, Tract 1290, consisting of 15 acres, upon which a value of $85,000.00 was placed, subject to incumbrances of $41,-940.00. It appears that the bankrupt purchased this property either in 1925 or 1926, for the purchase price of $40,000.00. [Tr. p. 60.] It further appears from the testimony of D. H. Culver, a qualified real estate man, that the reasonable value of the property, in his opinion, in September and October of 1930, was the sum of $30,000.00.

With respect to Lots 187 and 188, on Long Beach boulevard, a valuation was placed by the bankrupt again at $85,000.00, subject to an incumbrance of $29,000.00. It appears that the bankrupt purchased this property in 1929 or 1930, for the sum of $46,000.00. [Tr. p. 61.] The witness Culver testified that in his opinion these lots were, in September and October of 1930, worth the sum of $20,000.00. [Tr. p. 59.]

The bankrupt attempts to justify these obviously grossly exaggerated values upon the proposition that in his honest opinion the property was worth the valuations as placed on them, but this is the only explanation made for the phenomenal difference between the purchase price and the values placed by the bankrupt.

It appears further from the testimony of the bankrupt [Tr. p. 40] that the 400 shares of Emsco Derrick and Equipment Company stock, which was shown on Objectors' Exhibit 2, was the same as set forth in Objectors' Exhibit 4 at the sum of $4800.00. It further appears from the testimony of the bankrupt that there was nothing in the financial statement (Exhibit 2) to show that the stock had been pledged, which in fact it had. [Tr. p. 41 and p. 53.]

In Objectors' Exhibit 2, under General Information, "amount of notes or accounts payable secured" was given as the sum of $25,258.64, which sum was secured by stocks and mortgages pledged either with City National Bank, Bank of Inglewood, Bank of Lynnwood, and Conservative Mortgage Company. It further appears from his testimony that the bankrupt had prior to the giving of the financial statements pledged with the Union Indemnity Company, the stock of the Emsco Derrick and Supply Company and the stock in the City National Bank, which said stock was shown and reflected on Objectors' Exhibits 2 and 4, respectively. [Tr. p. 41.] No statement was made of the fact that 40 shares of the City National Bank stock had been pledged or placed with the Union Indemnity Company, in Objectors' Exhibit 2. [Tr. p. 41.]

It also appears that the bankrupt did not, in any of the financial statements, list his personal obligations. [Tr. p. 28.] It also appears that the bankrupt kept all the property which he owned with the exception of his home which was heavily encumbered and homesteaded under the laws of the state of California, in the names of persons other than himself, this fact being admitted.

POINTS AND AUTHORITIES.

Trustee contends that under the above circumstances which *are* practically *undisputed,* the financial statements rendered by the bankrupt were materially false or made recklessly and without honest belief that the statements were true, and for the sole purpose of deceiving the persons to whom the statements were rendered, for the purpose of securing credit thereon; and that such statements were false to such an extent that the bankrupt should be denied his discharge.

Here we have no less than five particulars mentioned in the various financial statements which are undisputably false. While it might be urged that any one of the above particulars or falsifications in itself, and standing alone, would be insufficient to deny a discharge, yet when considering the whole chain of false assertions that appear, we believe that it is undisputably apparent that the bankrupt gave these false financial statements with conscientious intention to deceive his creditors, and framed the statements with that objective in view, and purposely concealed his true financial condition, and that evidence wholly fails to support the finding of the Master "that the bankrupt did not make any false statements for the purpose of obtaining credit from the objecting creditors or either or any of them," but on the contrary, such evidence will only support a finding that the bankrupt did make such a statement for the purpose set forth.

Section 14, Subdivision 3, of the Bankruptcy Act, as it stood prior to 1926, reads as follows in part:

> "Or obtain money or property on credit upon a materially false statement in writing, made by him

for the purpose of obtaining credit from such person."

This section was amended in 1926, and now reads as follows:

"Obtain money or property on credit or obtain an extension or renewal of credit by making or publishing, or causing to be made or published in any manner whatsoever, a materially false statement respecting his financial condition."

In discussing the purpose and objects to be accomplished by the above section, the Supreme Court of the 8th Circuit, in *Swift v. Fortune,* cited at 287 Fed. 491, states:

"The discharge of bankrupts from the burden of a debt is a privilege which the law grants under certain circumstances. The theory is to enable the unfortunate honest debtor to be released from the oppressive burden of debt, to start anew with a clean slate and re-establish himself in business, thus not only helping him, but bringing about a resultant benefit to society. Its purpose is not to relieve the debtor from fraudulent conduct nor to put a premium on dishonest business methods. The law should not reward by a discharge such conduct of a bankrupt as is presented in this record. The findings of the Special Master and the Referee are not in accord with the evidence and are manifestly erroneous. The objection of the appellants to the discharge of the bankrupt upon the ground we have herein discussed should have been sustained."

It is to be noted in the above case that the Supreme Court reversed an order of the lower court confirming

a recommendation of a Referee granting a discharge, and the case is in a great many respects similar to the case at bar.

See also

Trumble v. Clareton, 55 Fed. (2nd) 165.

The general rule was laid down by the leading case of *Gilpin v. Merchants National Bank,* 165 Fed. 607. It was there found that the bankrupt did not know what the statement contained or did not know that it was materially false, and that he did not have a conscientious intention of deceiving the creditor. It was shown in this case that the financial statement was signed in blank by the bankrupt and was prepared by his bookkeeper and forwarded to the creditor without his inspection. The court held in construing section 14B, that the word "false" as therein used means more than merely "not true," but imports an intention to deceive, and that a financial statement, in order to bar a discharge in bankruptcy, must be knowingly and intentionally untrue.

The *September, 1932, Supplement to Remington on Bankruptcy, Volume 7, Section 3332½ (New)*, states:

> "By the amendment of 1926 the bankrupt is barred of his discharge if the materially false statement in writing respecting his financial condition was caused to be made or published by him 'in any manner whatsoever'; thus the fine distinctions theretofore prevalent under the law with regard to false financial statements as bars to discharge have been largely swept away; in short, if the bankrupt makes or 'causes' to be published in any manner whatsoever a false financial statement, he will be barred of his discharge."

Thus, statements given to mercantile agencies are sufficient. (*In re Licht,* 45 Fed. (2nd) 844.) Under the Amendment of 1926, the obtaining of an extension or renewal of credit, as well as the furnishing of credit, is sufficient. (*Royal Indemnity Co. v. Cooper,* 26 Fed. (2nd) 585.)

In *Volume 7 of Remington on Bankruptcy, Supplement to September, 1933, Section 3336,* it is stated:

> "By the amendment of 1926, eliminating the former words 'for the purpose of obtaining credit," it would seem that the specific intent to obtain credit formerly required need no longer be proved, and that it is now sufficient to prove merely that the bankrupt caused the financial statement to be made or published in such a way that it must be presumed he intended it to affect business actions; * * * the specific intent to obtain credit is no longer required; but if the bankrupt makes a false financial statement in such a way and to such person and under such circumstances as a reasonably prudent man would be presumed to know would likely induce the giving of credit or affect his standing, it would be sufficient."

In *Firestone v. Harvey,* 174 Fed. 574, it was stated:

> "The false statement in writing which is enough to deny a discharge implies a statement knowingly, or made recklessly without honest belief in its truth and with a purpose to mislead or deceive, and thereby obtain from the person to whom it was made property or credit."

In *Mori Mura v. Tabeck,* 279 U. S. 24 (73 L. Ed. 586), the Supreme Court, in denying a discharge in bankruptcy, used the following language:

> "It is established by the clear weight of the evidence that the written statement which was made to the Mori Mura Co. by Nathan Tabeck in behalf of the firm, and was acquiesced in by Julius Tabeck, was not only incorrect, but materially false within the meaning of section 12 of the bankruptcy act; that is, that it was made and acquiesced in either with actual knowledge that it was incorrect, or with reckless indifference to the actual facts without examining the available source of knowledge which lay at hand, and with no reasonable ground to believe that it was in fact correct."

In re Ellertree, 198 Fed. 952: The bankrupt, in order to purchase goods, made a statement to the sellers in writing. Among other things he listed real property at $14,000.00. In the bankruptcy schedules he listed the real property at $6450.00. It sold in the bankruptcy proceedings for $3000.00. No explanation was offered by the bankrupt as to this wide discrepancy. He was denied a discharge, the court saying:

> "The strongest case that I could find in favor of the bankrupt was Gilpin v. Merchants National Bank. (*supra.*)"

and also cites the quotation from the *Firestone v. Harvey* case, *supra,* and adopted the Master's findings, as follows:

> "That the bankrupt's estimate was inaccurate as to the value of the real estate there can be no doubt, and while the opinion is not entertained that a

> bankrupt should be so strictly bound by estimates as by statements of fact, yet it is believed that such estimates should not be so *grossly exaggerated* as to be suggestive of fraud."

The court further says:

> "It can hardly be said that the very remarkable overestimate in the value of the real estate could have been a mere mistake of the bankrupt. It must have been *overestimated for a purpose,* and that purpose, it must be concluded, was to obtain credit, etc."

Cases adhering to the same rule are:

In re Smith, 232 Fed. 249;

In re Fackler, 246 Fed. 865.

Another illustrative authority is *In re Simon,* 201 Fed. 1004, wherein the bankrupt grossly overestimated the value of his stock, and included large values on leaseholds on stores, which were valueless, the court saying in effect, in denying a discharge that the valuations placed upon the leaseholds were speculative and conjectural, and could have no other tendency than to mislead and deceive creditors.

Appellants earnestly insist that the conclusion is inescapable that the statements as given were given recklessly, by one who could not have helped but know that the valuations therein placed upon his various properties were inflated to such an extent that a creditor would be misled and lulled unto extending a line of credit based upon such statements. In other words, the bankrupt gave the statements, so as to speak, with his tongue in his cheek.

Other cases bearing upon the various particular items set forth in the financial statement are as follows:

In re Day, 268 Fed. 1871.

In re Blank, 236 Fed. 801, in which case a discharge was denied where statements of the bankrupt's financial condition omitted an indebtedness for money borrowed from a building and loan association even though it was contended that such omission was immaterial because the money so borrowed was secured by a mortgage or pledge of stock in such building and loan association, and even though the mortgage was recorded under the recording statutes. This affords no excuse. This decision also distinguishes the *Gilpin* case, *supra,* upon the principal of "Scienter," stating that the bankrupt had no actual knowledge that his statement was false.

In *In re Josephson,* 229 Fed. 272, it was held that the intent to deceive may be deduced from all of the facts and circumstances, such as the failure to keep books.

In *In re Wollff,* 11 Fed. (2nd) 293, it was held that discrepancies appearing in a financial statement were of sufficient importance and so grave as to justify a conclusion that they were not made ignorantly and in good faith.

Here we again wish to stress the fact that there was a difference of some $43,671.37 in the amount of the incumbrances shown by the bankrupt upon his financial statements and as actually existed.

In *In re Maagett,* 245 Fed. 804, it was held that knowingly omitting from the statement actual obligations, even

though with the thought that no harm would result, was such conduct as not to be commercially tolerable.

In *In re Terens,* 172 Fed. 938, carelessness in signing a financial statement without due consideration of the facts was regarded as not excusing the bankrupt.

In *Josephs v. Powell and Campbell,* 213 Fed. 627, it was held that where a bankrupt omitted a part of his indebtedness, even though he afterwards secured a release from the creditor of such omitted debts in the bankruptcy proceedings, that the bar to the discharge was complete.

In *In re Russell,* 52 Fed. (2nd) 749, it was held, where a bankrupt listed stock as an asset in his financial statement, and did not list the liabilities under which the securities were hypothecated, he obtained an extension of credit by false statements and should be denied his discharge.

In *In re Woolen Corp. v. Getting,* 33 Fed. (2nd) 259, statements were made in ignorance of the facts, without examination of the books, and the court held under such circumstances that these statements were made with such reckless indifference to the truth as to bar a discharge, although there was no wilful misstatement.

In *In re Keller,* 2nd Fed. Supp. 520, it was held that the school owner's failure to inform a corporation lending him money in reliance upon representations as to the school's surplus, that interest on bonds secured by a mortgage on the school's property, and taxes thereon, were unpaid, was sufficient to bar a discharge.

In *In re Schafer,* 169 Fed. 724, the bankrupt obtained goods on credit by reason of a false financial statement, which gave his liabilities as $2536.00, whereas they were in excess of $11,000.00. Extenuating circumstances were shown by the bankrupt. However, the discharge was refused, the court saying:

> "If it were a matter of discretion with me I frankly confess that extenuating circumstances in the case would lead me to grant this discharge, but upon a careful investigation of the law governing the matter, I am constrained to reach the conclusion that I am not permitted under the circumstances so to do. . . . Under the construction given it (Sec. 14B) the objecting creditor has to establish two things, (1) that the bankrupt obtained property or credit, and (2) that he made to the person from whom he obtained it, a materially false statement in writing for the purpose of so obtaining it. The good but mistaken faith with which such statement is made cannot be taken into consideration. The statement must be materially false. In fact it is not necessary that it be substantially false. . . . That the statement made by the bankrupt in this case was materially false, although it may have been unintentionally so, it seems to me is clearly shown, . . . etc."

The appellants submit that the above authorities cover the several respective instances in which the financial statements appear to be materially false. Considering these various items, then, with the fact that the bankrupt admittedly carried his real property in the names of dummies or persons other than himself, it leads to the conclusion that the bankrupt has transgressed the very purposes and abuses which section 14B seeks to cure. In

other words, such section was designed to prevent the very acts which the bankrupt here has committed, and as is said in *7 Remington on Bankruptcy,* at page 355,

> "However, grounds for refusal of a bankrupt's discharge are not limited to those acts which tend to deplete the estate and to make discovery of its true condition difficult, but are broad enough to include acts which demonstrate the bankrupt's unworthiness to be a member of the business community, entitled to credit."

The Special Master observed that in the case at bar

> "This young man has been guilty of some high financing; I don't think his conduct along that line has been what it might have been." [Tr. p. 68.]

We submit that the bankrupt was guilty of more than high financing, but was guilty of downright fraud and misrepresentation. Certainly a discrepancy of forty-three thousand odd dollars in incumbrances on property without any explanation by the bankrupt, smacks of fraud and not high financing. As was said *In re Ellertree,* 198 Fed. 952:

> "If the indebtedness of the bankrupt had increased from $10,550.00 to $16,046.31 between August and December, as indicated by the Master's report, there should be some explanation as to how the indebtedness was increased to this large amount without a corresponding increase in assets. But even passing this by, it could hardly be said that the very remarkable overestimate in the value of the real estate could have been a mere mistake of the bankrupt; it must have been overestimated for a purpose, and that purpose, it must be concluded, was to obtain credit."

There is absolutely no attempted explanation by the bankrupt of this differential in incumbrances on real estate. He does attempt to justify the differential in valuations of real property by the shrinkage in real property valuations. However, we wish to point out that with respect to Lots 187 and 188, on which he placed a valuation of $85,000.00 in October of 1930, and which land was purchased by him possibly during the same year, that would in no event account for a shrinkage of more than half of the value of the property, taking into consideration as we might the abnormal shrinkage of real property due to economic conditions.

The appellants are of the firm opinion, therefore, that the bankrupt deliberately set out to deceive and mislead his creditors, in order to gain an advantage over them. Such conclusion seems unescapable when viewed in the light of the entire surrounding conduct of the bankrupt, which in the apppellants' opinion, was such as to require a demand of his discharge in bankruptcy.

We respectfully submit that the order herein complained of should be reversed and the cause remanded to the District Court with directions to deny the bankrupt his discharge.

Respectfully submitted,

RAPHAEL DECHTER,

Attorney for Appellants.